No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Appellees.

BRIEF FOR APPELLANT

MAURICE E. HARRISON,
T. W. DAHLQUIST,
JAMES S. MOORE, JR.,
Attorneys for Appellant.

BROBECK, PHLEGER & HARRISON,
710 Crocker Building,
San Francisco, California,

ORRICK, DAHLQUIST, NEFF & HERRINGTON,
Financial Center Building,
San Francisco, California,
Of Counsel.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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BRIEF FOR APPELLANT

STATEMENT OF PLEADINGS AND FACTS SHOWING JURISDICTION.

The District Court had jurisdiction under Title 28, U. S. C., Sec. 400, and under Title 28 U. S. C., Sec. 41(1), the matter in controversy exceeding the sum of $3,000 and the action arising under the laws of the United States. The action was instituted in the United States District

References (R. ....) are to pages of the Transcript of Record.
All emphasis herein is supplied by us.

Court for the District of Nevada by Reconstructio Finance Corporation, a corporation organized under th laws of the United States (15 U. S. C., Sec. 601), all o the stock of which is owned by the United States (1 U. S. C., Sec. 602). It was brought to obtain a declaratio that the plaintiff is entitled to a lien upon stock of certai reservoir and canal companies alleged to be appurtenan to lands in the State of Nevada subject to a mortgag which had been assigned to plaintiff (Complaint, R. 2) During the pendency of the action the mortgage was fore closed, the property subject thereto was sold, and Pacifi States Savings and Loan Company, a California corpora tion, which had succeeded to the interest of plaintiff i the property in controversy was substituted as plaintif (Supp. Bill of Complaint, R. 32, Order R. 78, and Stipu lation R. 132).

Issue was joined (Answer, R. 17, and Stipulation R. 78 and 132) upon the original bill and supplementa bill.

From the final judgment (R. 61 and 66) this appea has been prosecuted by the substituted plaintiff. This court has jurisdiction of the appeal under Title 28, U. S. C. Sec. 225(a).

STATEMENT OF THE CASE.

A. THE ACTION.

This action was commenced by Reconstruction Finance Corporation (hereinafter referred to as R. F. C.) to obtain a declaration that the stock of certain reservoir and

tch companies described in the complaint is subject to ıe lien of a mortgage executed by the then owner of ertain lands in the Lovelock Valley, also described in the mplaint, made to The Reno National Bank and by it ssigned to the R. F. C. The facilities of the reservoir nd ditch companies had for many years been used to rigate the mortgaged lands, and it was claimed that the tocks of these companies were an appurtenance to the nd and as such subject to the mortgage. It was also laimed that whether or not an appurtenance, the stocks ad been in fact mortgaged. During the pendency of the ction the mortgage was foreclosed and appellant Pacific States Savings & Loan Company, which had acquired title o the mortgaged property, was substituted as plaintiff nd by supplemental complaint asserted its rights to the tocks in question as the owner thereof.

Defendant, who is receiver of four Nevada state banks, by his answer asserted an attachment lien on behalf of three of the banks for which he is receiver, but no evidence was introduced in respect of such alleged attachment liens. On behalf of Bank of Nevada Savings & Trust Company, of which he is also receiver, defendant asserted a lien under a pledge agreement executed subsequent to the mortgage of the land by one John G. Taylor, in whose name the stock in question stood of record.

The District Court found that the companies whose stock is here in controversy have at all times been engaged solely in the maintenance and operation of certain reservoirs and ditches for the diversion of waters in the Humboldt River and their transmission to lands in the Lovelock Valley and that plaintiff, as owner of the lands

in question, became and is entitled to all water rights and the use of the necessary facilities for irrigation as an appurtenance to the lands conveyed. The court, however found that plaintiff was not entitled to the stock in question otherwise than as it might be affected by the water rights found to be owned by plaintiff (Opinion, R. 35). The substituted plaintiff has appealed from the decree in respect of this latter determination.

B. THE APPELLANT'S GROUNDS FOR REVERSAL.

Appellant will rely on the following propositions as grounds for reversal:

1. **The stock in controversy is appurtenant to the land and passed by conveyance thereof.**

This question is raised by the allegations of the bill of complaint and by the findings of fact of the court below. The conclusions of law and the decree of the court below are claimed to be unsupported by the findings of fact and contrary to the legal effect of the facts found.

2. **The defendant and the bank of which he is receiver are not bona fide purchasers for value.**

This issue was raised by the bill of complaint. The court below made no findings thereon.

C. STATEMENT OF THE FACTS.

Prior to June 9, 1930, John G. Taylor owned, with other property, certain lands in the Lovelock Valley, Humboldt County, Nevada, specifically described in the complaint. Without water these lands are practically valueless, but with water for irrigation they are productive and of sub-

antial value. While the lands have certain rights to the se of the waters of the Humboldt River based on appro- riation and diversion for beneficial use, these rights are f such late priority that only in times of exceptional ater conditions are they sufficient fully to irrigate the nds in question (Finding XIX, R. 55). Under an appro- riation made by Humboldt Lovelock Irrigation Light & ower Company that company is authorized to maintain dam known as the Pitt-Taylor Reservoir and impound ertain waters of the Humboldt River during flood seasons o supplement the vested water rights of certain lands escribed in the permit, including the lands then owned y Taylor and now owned by plaintiff (Finding XX, R. 56, Exhibits 11 and 12, R. 107). In the transmission f the waters so impounded in the Pitt-Taylor Reservoir, s well as under the direct appropriation, the ditches wned by Young Ditch Company, Old Channel Ditch Com- any and Union Canal Ditch Company are used. Such vas the situation for many years prior to June 9, 1930, nd such continued to be the situation thereafter.

On June 9, 1930, John G. Taylor conveyed to John G. Taylor, Inc., a Wyoming corporation, all of the lands in question, "together with the appurtenances * * * also ll water rights, ditches and canals appurtenant to said and or used in connection therewith, and all shares of stock of any water corporation appurtenant to said land or the water from which are used or have been used in connection with the irrigation or cultivation thereof" (R. 79, Finding X, R. 49). The stock of the four water companies continued to stand in the name of John G. Taylor, and still stands in his name (R. 142, 143). The

water, however, continued to be used for the Taylor lands as it had been prior to the conveyance to John G. Taylor, Inc. and is still so used (Finding XVI, R. 54).

On April 20, 1932 (R. 80), John G. Taylor, Inc. mortgaged to The Reno National Bank, as security for an indebtedness of $700,000 evidenced by a promissory note dated March 12, 1932, all of the lands in question

> "Together with all water, water rights, water applications and water permits, or privileges, connected with, belonging, appurtenant or incident to the lands hereby conveyed, or used in connection with all or any part of the said premises, or used or usable in connection therewith, and all dams, reservoirs and ditches, canals or other works for storage or carrying of water now owned by the mortgagor, or in which it now has, or may hereafter acquire any interest, and all applications now pending in the office of the State Engineer of the State of Nevada, for any and all waters to be used upon any part or portion of the said lands, or used in connection therewith.
>
> "Together with all and singular the tenements, hereditaments and appurtenances thereunto belonging, and in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof."

This mortgage was dated as of March 12, 1932, the date of the note, and replaced, to correct an error in description, a mortgage executed on March 12, 1932 (Complaint, R. 7 and Answer, R. 19). It was executed without the formalities, required by law respecting the mortgage of chattels (R. 81). A chattel mortgage dated March 12,

932 was also executed but did not describe the stock in uestion (R. 81). This note and the mortgages securing he same were assigned by The Reno National Bank to Reconstruction Finance Corporation to secure in part a oan exceeding One Million Dollars made by the R. F. C. o The Reno National Bank (R. 81). Default having oc-urred, the mortgage was foreclosed, the property sold, nd the property subsequently conveyed to Pacific States Savings & Loan Company (R. 132).

At the time the mortgage from John G. Taylor, Inc. to The Reno National Bank was being arranged as a con-solidation of various loans then held by the bank, rep-resentatives of the R. F. C. were in consultation with the representatives of The Reno National Bank, it being then contemplated that the mortgage was to be assigned to the R. F. C. (R. 104-106, 147-148). The lands in question were represented as possessing water rights and as being the most valuable of the Taylor lands by reason of their agricultural possibilities through the possession of such water rights (R. 104-105). It was not known by the R. F. C. that the water rights were in any way represented by the stock of corporations (Finding XIV, R. 52). Mr. Sheehan, then executive vice-president of The Reno National Bank, through whom the transaction was ar-ranged, testified that it was understood the mortgage was to cover all property of every kind owned by the Taylor Company, and that company agreed that it should; also that the water rights and all incidents thereto were in-cluded (R. 147-148).

The Bank of Nevada Savings & Trust Company, a state bank, was owned by the same interests as owned the

stock of The Reno National Bank. It occupied the same banking rooms and had the same officers and directors and personnel (R. 144). Subsequent to the execution of the mortgage from John G. Taylor, Inc. to The Reno National Bank and its assignment to the R. F. C., a pledge agreement was signed by John G. Taylor personally, dated April 29, 1932, pledging to the Bank of Nevada Savings & Trust Company as security for then or future indebtedness certain described stocks, including with others, the stocks here in question. At that time Taylor was not indebted to the Bank of Nevada Savings & Trust Company, but subsequently various sums were borrowed from that bank by John G. Taylor, Inc., the notes being endorsed by John G. Taylor (Finding XV, R. 53). The same Mr. Sheehan acted for the Bank of Nevada Savings & Trust Company in authorizing these loans. He testified that he did not then know of the pledge agreement, did not see the certificates representing the water stocks, and in fact did not recall having seen them until the day of the trial (R. 146). Mr. Sheehan is the same person who had handled the $700,000 note and mortgage transaction and who testified that he demanded that there be hypothecated to secure that note all the property which Taylor owned individually as well as all property which his corporation, John G. Taylor, Inc., owned (R. 145-146).

The notes payable to the Bank of Nevada Savings & Trust Company not having been paid, defendant, as receiver of that bank, claims a lien upon the stocks. While the pleadings indicate a claim of defendant, as receiver of three other Nevada state banks, by virtue of attachments, there is no evidence in the record disclosing the nature or extent of such lien.

The articles of incorporation and stock certificates of the four water companies whose stocks are here involved appear in the record (R. 82, 89, 93, 94, 122, 127 and 134). With the exception of the Humboldt Lovelock Irrigation Light & Power Company, there is nothing in the articles, by-laws or stock certificates of these companies indicating any particular restrictions on the disposition of the stock or priority to their stockholders in the use of their respective facilities. However, the court found and evidence shows that the only assets of these companies are the ditches constructed by use of the proceeds of the sale of their stock to landowners served by the ditches; that their only business is the maintenance of these ditches in the transmission of water to the lands of the stockholders; that their only revenue is obtained from assessment upon the stockholders to meet the operating expenses; that in practice the use of their facilities has always been confined to stockholders, and that their stocks have been transferred only as an incident to a transfer of lands. In some cases transfers in pledge have been made in connection with mortgages of the lands of the stockholders, principally to the Federal Farm Loan Bank (Finding XVII, R. 54 and R. 123-137).

The stock of the Humboldt Lovelock Irrigation Light & Power Company is of two classes—Class A and Class B. Only Class A stock is here involved. The articles of incorporation of that company provide that:

> "* * * the stockholders of our said corporation shall always be entitled, by virtue of being such stockholders, to a preferential use, over all other persons, natural or artificial, of all water owned or

possessed by our said corporation for the irrigation of lands owned or possessed by such stockholders; * * *." (R. 82)

It is further provided:

"* * * Class A stock shall have certain preferential rights over Class B stock, to wit: Class A stock shall be entitled to the preferential use of water from the Company of a maximum quantity of 10,000 acre feet each year, to be distributed pro rata if requested, for the irrigation of lands owned or irrigated by such stockholder, lying under or irrigated by means of water used through either the Irish American or Last Chance, Old Channel, Young or South West Ditch or ditches, situated in Lovelock Valley, Nevada; that such preferential use shall be expressly limited to such lands lying under said named ditches, and upon Class A stock being transferred to a transferee not a holder of Class A stock and not entitled to exercise such preferential use, Class B stock shall be issued to such transferee in lieu of the Class A stock so transferred; * * *" (R. 85)

This preferential right is repeated in the form of stock certificate (R. 128).

As in the case of the other companies, the only asset of Humboldt Lovelock Irrigation Light & Power Company is the so-called Pitt-Taylor reservoir. Its only activity has been in the maintenance of that reservoir and distribution of water to its stockholders. Its stock also was issued only to landowners served thereby. Its only revenue is the charge made against its stockholders and assessments on the stockholders to meet the operating expenses of its facilities (Finding XX, R. 56). Although

ts articles of incorporation would permit engagement n other lines of business "it has never engaged in any usiness or activity other than the business or activity of acting as the agent of its stockholders in diverting and storing water to be applied to a beneficial use upon the lands owned by such shareholders" (Finding XX, R. 56) and its by-laws provide:

> "Sec. 1. The proper irrigation of lands belonging to the stockholders of this Company shall always be this Company's primary object, and during the irrigating seasons no waters of this Company shall ever be used for any other purpose if such waters are necessary to properly irrigate the lands of the Company's stockholders." (R. 132)

ASSIGNMENTS OF ERROR RELIED UPON.

Plaintiff relies upon and will rely upon the following assignments of error: (Note: The Roman Numerals refer to the assignments and Arabic numbers to the respective pages of the record.)

II (70); III (70); IV (70); VII (71); VIII (71); IX (72); X (72); XI (72).

ARGUMENT.

I THE STOCK IN CONTROVERSY IS APPURTENANT TO THE LAND AND PASSED BY CONVEYANCE THEREOF.

Assignments of Error Involved:

"11.

"The Court erred in failing to find that said water stocks were and are appurtenant to the lands de-

scribed and referred to in said complaint now owned by plaintiff, and that said water stocks were transferred by the deed and mortgage of said lands."

"2.

"The Court erred in making and entering its decree that plaintiff is not entitled to a judgment declaring that said water stocks are subject to and conveyed by the lien of the real estate mortgage described in the complaint herein."

"3.

"The Court erred in not making and entering its judgment that plaintiff is the owner and entitled to the possession of said water stocks and that defendant has no right, title or interest therein or thereto or any lien thereon."

"4.

"The Court erred in not making and entering its decree that defendant surrender and deliver said water stocks to plaintiff."

"7.

"The Court erred in failing to find that, by virtue of the deed described in Finding X, said water stocks were sold, assigned and transferred by John G. Taylor to John G. Taylor, Inc., a corporation."

"8.

"The Court erred in failing to find that, by virtue of the mortgage referred to in Finding XI and XII, said water stocks were mortgaged by John G. Taylor, Inc. to The Reno National Bank."

Discussion:

The District Court rightly concluded that plaintiff as successor in ownership of the lands described in the complaint, is the owner of all water rights appurtenant thereto, including all rights to all means of transportation and storage of water such as dams, ditches, canals, and reservoirs, from the places or points of diversion to the places or points of use (Opinion, R. 44). With the exception of the Humboldt Lovelock Irrigation Light & Power Company, none of the companies, the stock of which is involved in this litigation, is possessed of any right to appropriate water. A decree of the state court which adjudicated the right to divert water from the natural flow of the Humboldt River, expressly provides that the rights therein confirmed are appurtenant to the place of use (R. 104), and the certificates which constitute the sole basis of the water rights possessed by the Humboldt Lovelock Irrigation Light & Power Company provide "that the right to water hereby determined is limited to the amount which can be beneficially used, not to exceed the amount above specified, *and the use is restricted to the* place where acquired and to the purpose for which acquired" (R. 109-112).

It is clear, therefore, that all water rights possessed by the owner of the stock involved in this suit are vested in the plaintiff, and under the doctrine enunciated by the Supreme Court of Nevada in *Prosole v. Steamboat Canal Company*, 37 Nev. 154, 140 Pac. 720, plaintiff is entitled to an easement in the ditches, reservoirs and other irrigation works of the respective companies for the diversion,

storage and conveyance of water from the place of diversion to the point of use upon plaintiff's land.

It is appellant's contention, however, that not only the right to receive water and to the use of the facilities of the respective companies for the diversion, storage and conveyance of water, are appurtenant to the land, but the stock itself is appurtenant to the land, and that the court erred in not so decreeing.

At the outset it should be noted that stock in the hands of one other than the plaintiff has nothing more than a nuisance value, since none of the companies has ever been operated for profit, or has ever derived any income except from assessments and charges collected from their stockholders in amounts sufficient to cover only the bare cost of maintenance and operation, or has ever engaged in any activity other than operating irrigation works for the benefit of and as common agent for the persons who have applied the water to a beneficial use, or has ever owned or possessed any assets except irrigation facilities which are subject to easements in favor of the persons who have applied the water to a beneficial use. In this aspect, the situation here is much the same as that described in *Twin Falls L. & W. Co. v. Twin Falls Canal Co.*, 7 Fed. Supp. 238 (affirmed C. C. A. 9, 79 Fed.(2) 431, certiorari denied 80 L. ed. 466), where the court said:

> "* * * Each share was then to represent a water right plus a proportionate interest in the property which plaintiff was to hold in trust for defendant until the project was transferred to the latter. But a water right can only exist when appropriated for and appurtenant to land upon which a beneficial use

of the flow can be made. They were, when issued, only indicia of a water right dedicated to a definite parcel of land. If sold and appurtenant to land, each share constitutes a proportionate interest in the works and the water. Unsold, a share is of potential value only under peculiar conditions. It cannot be placed on the market like industrial stock and sold to the public at large. The purchaser must be in a position to apply the water represented to a specific tract of land, subject to irrigation from the original appropriation. The most potent factor is that when all the water appropriated has been applied to a beneficial use, a share of stock has no value, actual or potential, except for nuisance purposes."

On the other hand, unless plaintiff is adjudged and decreed to be the owner of the stock, plaintiff stands the risk of being deprived of the enjoyment of the very rights which the court held to be vested in plaintiff.

The articles of incorporation of the Humboldt-Lovelock Irrigation Light & Power Company, as the findings show, provide that holders of the Class A stock of that company shall be entitled to the preferential right to the first 10,000 acre feet of water stored in the Pitt-Taylor Reservoir annually, and that in the event that any Class A stock is transferred apart from the land of its owner to a person not the owner of Class A stock, the stock will immediately become Class B stock. It is probable that the right to receive water from the company is so far appurtenant to the land that it will follow the land even though the stock falls into the hands of other owners. But the articles of incorporation do not so provide,—on the contrary they

provide just the opposite. The court has no power in these proceedings to pass upon the validity of the company's articles, and unless the articles are invalid, then, in failing to decree that the plaintiff is the owner of the stock of the Humboldt-Lovelock Irrigation Light & Power Company, the court has placed it within the power of the defendant to deprive plaintiff of the preferential right to receive from the Humboldt-Lovelock Irrigation Light & Power Company the water which the court decided the plaintiff was entitled to receive.

The situation in reference to the ditch and canal companies is much the same. Plaintiff contended and the court held that the canals and other facilities for the diversion and transportation of water owned by these companies are subject to easements in favor of the owners of the lands which have been irrigated by means of water carried through such canals and ditches. The fact remains, however, that the right to have the water transported through the canals and ditches is evidenced by stock, and the stock has no value except as evidence of that right. Accordingly, in the event that the stock is ever transferred to a person ignorant of the rights of the plaintiff as adjudicated in this proceeding, it would be open for the purchaser of such stock to contend that the plaintiff is not entitled to the enjoyment of the right to the use of the ditches and easements. While such a contention might be without merit the adjudication made in this proceeding is not binding upon any of the respective companies, nor would an innocent purchaser of the stock be bound by it.

On the facts of the case as found by the court on unrefuted evidence, it is manifest that the court erred in

failing to decree plaintiff to be the owner of the stock free and clear of any claim of the defendant. The lands referred to in the complaint had a value of between $50 and $100 an acre if irrigated, but a value of only $2.50 an acre if not irrigated (R. 116); if deprived of water from the Pitt-Taylor Reservoir the lands would have a value of approximately one-half of the value placed upon them as irrigated lands (R. 117); the water carried in the ditches of the several ditch companies is devoted to a beneficial use upon the lands referred to in the bill of complaint (R. 54); there is no other way of irrigating the lands than through the ditches mentioned (R. 56); in making its loan to The Reno National Bank the Reconstruction Finance Corporation relied on the representations of the executive vice president of The Reno National Bank who was also the executive vice president of the Bank of Nevada Savings & Trust Company, that the lands were irrigated lands (R. 105).

In these circumstances the great weight of authority is that stock of corporations such as those here involved is appurtenant to the land.

In *In re Thomas Estate*, 147 Cal. 236, 81 Pac. 539, the California Supreme Court was called upon to decide whether stock in a water company similar to those companies involved in this suit should be distributed to the residuary legatee or to the devisee of the real estate. The court said:

> "No by-laws were adopted or certificates of stock issued in conformity with section 324 of the Civil Code as amended in 1895, providing that shares of stock in a water company, when the section is com-

plied with, shall be appurtenant to the land described in the certificate. But in this connection it is proper to note the fact that the corporation was formed, and its practice of distributing water to its stockholders established, more than three years before the passage of this amendment, and while it is true that nothing can be claimed by respondent under this law, it remains equally true that if before its enactment the water-right became appurtenant to the tract devised to her by other lawful means the law has no invalidating effect upon the right so acquired."

* * * * * * * *

"* * * But it does not follow from this that the shares in controversy could not be appurtenant to the land. Conceding that they were so far personal property that the decedent might have transferred the water right by indorsement of the certificate, and thereby have severed the water-right from his land, it remains undeniably true that the right represented by the certificate—the right to receive eight hours' run of water in his turn—was appurtenant to the land, though deemed personal property with reference to the mode of transfer. In this view the stock certificate was merely the evidence of a water-right, which right, though capable of severance from the land to which it had become appurtenant, never was alienated or diverted by the decedent in his lifetime, but remained appurtenant to the six acre tract at the date of his will and at the time of his death. Therefore it was entirely proper to direct a transfer of the certificate to the respondent. It is her muniment of title and passes with the right of which it is the evidence, just as title deed should go to the distributee of real property.

"Nor is it any objection to the decree that the corporation may be interested in the disposition of its stock. It is not easy to see how a corporation is a necessary party to a controversy between third parties as to the ownership of particular shares of its stock; but if the Trabuco Water Company has a possible interest in this controversy it is not bound by the decree and remains free to maintain its adverse rights whenever they are drawn in question."

In re Johnson's Estate, 64 Utah 114, 228 Pac. 748, 750, was a case involving substantially similar facts. It was there held:

"Deceased left a water right represented by 56½ shares of the capital stock of the Union & Jordan Irr. Company, which, during his lifetime, had been used for the irrigation of the land owned and left by him. The water rights were appraised together with and as a part of the land. When Tract B was sold, 12½ shares of the water stock was transferred with it. Appellants, claiming the 44 remaining shares of water stock as an appurtenant to tract A of the real estate, prayed for its distribution to them. It was alleged and not denied that the water right was used in connection with the land, and that the land is of little or no value without the water right. The trial court found that the water right had been used for the irrigation of the lands owned by the testator, but that notwithstanding such use the same was personal property, and was not included in the devise to appellants. The question is whether a water right so owned and used will pass by the devise, without mention, with the land as an appurtenance.

"* * * The right to the use of water for irrigation is inseparately related to land. Without its continued

use upon land the right ceases. The customary practical presumption is that water rights used upon land are appurtenant to and a part of it. In this arid country, in most cases, 'farm lands' are valueless without water. It is inconceivable that the testator in this case intended to devise 'eleven acres above-mentioned of my farm land' and not include the water rights, upon the use of which depends the enjoyment and value of the property and without which it would scarcely be 'farm land'.

"Upon principle and authority we conclude that the water right referred to passed by the will as an appurtenance to the land selected by the executor, and that the same should be distributed to the appellants with the land.

"The judgment appealed from is reversed and set aside, and the district court directed to enter a decree in accordance with this decision awarding and distributing the whole of Tract A of the real estate, as described, together with the 44 shares of capital stock of the Union & Jordan Irrigation Company, representing the water right, to appellants. The decree should also include as an appurtenance to the land devised the right of way reserved across tract B to provide the necessary access from the public highway. With respect to the division of the property devised between appellants, the court will make such disposition in accordance with the will as the circumstances may require."

In *Ireton v. Idaho Irrigation Company,* 30 Idaho 310, 164 Pac. 687, it appeared that one Lansdon mortgaged to Boise Title & Trust Company 160 acres of land, together with all water rights owned by the mortgagor or belong-

ing or connected with the mortgaged premises. This mortgage was recorded on January 8, 1912 and the mortgaged property was on the 13th day of March of the same year sold upon the foreclosure of the mortgage, to the plaintiff Ireton. At the time of the execution of the mortgage Lansdon was the owner of certain shares of stock in Big Wood River Reservoir & Canal Co. Ltd. The shares represented a proportionate interest in certain irrigation works and entitled the holder thereof to certain quantities of water. Water was actually delivered to and applied to a beneficial use upon the mortgaged lands during 1911. Prior to the execution of the mortgage, namely, on April 1, 1910, the defendant Lansdon had executed an agreement conferring upon the defendant Idaho Irrigation Company, a lien upon the stock. This contract was not recorded, but after the recordation of the mortgage the stock was transferred on the books of the company, the stock certificates were transferred to the defendant. Both the plaintiff and defendant claimed the stock. The Supreme Court of Idaho held that the stock was appurtenant to the land and passed with the mortgage. In so doing the court said (p. 689):

> "It is contended by appellant that the shares of stock in the operating company are personal property, and that the water right passed by assignment of them, and did not become subject to the mortgage on the land. While shares of stock in an ordinary corporation, organized for profit, are personal property (Section 2747 Rev. Codes; State v. Dunlap, 28 Idaho 784, and cases therein cited on page 802, 156 Pac. 1141), and while this court has held shares in an irrigation company to be personal property (Watson

v. Molden, 10 Idaho 570, 79 Pac. 503) the fact must not be lost sight of that a water right is, as heretofore shown, real estate, and that in case of a mutual irrigation company, not organized for profit, but for the convenience of its members in the management of the irrigation system and in the distribution to them of water for use upon their lands in proportion to their respective interests, ownership of shares of stock in the corporation is but incidental to ownership of a water right. Such shares are muniments of title to the water right, are inseparable from it, and ownership of them passes with the title which they evidence. In re Thomas' Estate, 147 Cal. 236, 81 Pac. 539; Berg v. Yakima Valley Canal Co., 83 Wash. 451, 145 Pac. 619, L. R. A. 1915D, 292.

"It follows that, since respondents' mortgage is a prior lien upon the land and upon the water right appurtenant thereto, their claim to the shares of stock, which evidence that water right, is superior to that of appellant."

In *Yellowstone Valley Company v. Associated Mortgage Investors,* 88 Mont. 73, 290 Pac. 255, it appeared that the plaintiff owned two tracts of land and also stock in a mutual ditch company which provided irrigation for the said land. To secure loans, the plaintiff owner executed three mortgages on this land, each with a similar provision covering all irrigation rights, whether represented by capital stock of ditch or water companies or by direct ownership, and at the same time assigned the certificates representing the water rights to the mortgagee. In applying for the loans the plaintiff represented that the lands were irrigated and the mortgages were made on the basis of

irrigated land values. Without irrigation the lands were semi-arid in character and comparatively without value. The loans were based on the value of the lands as irrigated lands with water rights attached thereto; without water upon the lands the loan value upon the same would have approximated less than 30% of the loan value for irrigated lands; the lands at all times required all the water that could be secured from the ditch by the owners of the shares of stock. The plaintiff being in default as to the payment of the second and third of these mortgages, the holder of them foreclosed and bid the property in at the foreclosure sale. The sheriff's certificate of sale and deed failed to mention the appurtenances, water, water rights, or shares of stock, and this was a suit by the plaintiff to recover possession of the shares of stock or their value. It was held that while shares of stock in an ordinary corporation, organized for profit, are personal property, the fact could not be lost sight of that a water right is real estate, and that in the case of a mutual irrigation company, not operated for profit, as in this case, the ownership of shares of stock in the corporation is but incidental to the ownership of a water right, and ownership of them passes with the title which they evidence, subject, in this case, to the lien of the first mortgage. In so doing, the court said:

> "Plaintiff's theory is that the shares of stock in the Ditch Company are personal property, are not and cannot be appurtenant to the land; that the stock was hypothecated to the defendant by way of pledge, and, the pledge not being foreclosed when the defendant bid in the lands for the full amount of the

judgment, the stock was released from its pledge, and the debt being paid, the defendant has no interest therein.

"The determinative question is: Under the facts and circumstances shown, did the mortgage include the water rights represented by the shares of stock?

"* * * As is shown in the agreed statement of facts, the land in question was irrigated, and without irrigation was of little value. It appears conclusively that the water obtained from the canal of the Big Ditch Company was essential to the use of the land in question, and had been used thereon for thirty years or more. Upon the facts shown there can be no question that the water rights represented by the shares of stock in the Big Ditch Company were appurtenant to the lands. The authorities sustain this position. The fact that the certificates of stock—evidences of ownership of an interest in corporate property—are personal property, does not militate against this statement. Personal property can become an appurtenance to land without attachment or annexation. * * *

"The doctrine announced in the foregoing cases is suited to our history and conditions and meets with our approval. Defendant's counsel cite decisions from the Supreme Court of Colorado to sustain the decision of the lower court, but with these we are unable to agree.

"We do not overlook the point that whether a water right evidenced by shares of stock is appurtenant to the land upon which the water is used is a question of fact. But, upon the conceded facts, that question does not trouble us: clearly, the water is appurtenant to the land. Such being the case, the governing rule is that everything essential to

the beneficial use and enjoyment of the property conveyed is, in the absence of language indicating a different intention on the part of the grantor, to be considered as passing by the conveyance. Sheets v. Seldon, 2 Wall. 177, 17 L. ed. 822. The owner of land with an appurtenant water right may by appropriate conveyance, convey the land to one person and the water right to another. But, if he conveys the land without reservation, he also conveys the appurtenance and whatever is incidental to the land. He therefore conveys the appurtenant water rights, unless he expressly reserves them. If the water rights are represented by stock in an irrigation company such as the Big Ditch, he may, of course transfer the water right by mere assignment of the stock to one person and may convey the land by deed to another person. As a matter of course, controversies may arise in transactions of this nature in which it may be necessary to ascertain whether a grantor has intended to sell the water to one person and the land to another. But here, where it is clear that the mortgagor intended to convey both the land and the appurtenant water to the mortgagee to secure the payment of debt, the question does not arise." (page 257)

From the foregoing authorities we submit that the conclusion follows inevitably that the shares are muniments of title to the water rights which are admittedly vested in the plaintiff; that they are inseparable from those rights and that ownership of the shares passes with the title which they evidence. Such being the case, the shares passed with the conveyance of the land by John G. Taylor to John G. Taylor, Inc. on April 9, 1930 and

became subject to the mortgage of the lands executed by John G. Taylor, Inc. to The Reno National Bank and passed with the conveyance under the decree foreclosing that mortgage to plaintiff's predecessor in interest and by mesne conveyances to the plaintiff. The shares being appurtenant to the land and passing with the conveyance thereof, it is obvious that the bank, of which the defendant is the receiver, acquired no lien upon the stock by virtue of the pledge agreement executed by John G. Taylor more than two years after he had parted with ownership of the land to which they were appurtenant.

The District Court declined to decree the plaintiff to be the owner of the shares free from any claim of the defendant, on the ground that while the companies had no water rights, the stock might nevertheless represent some other more or less valuable rights, saying in this connection:

> "A reference to the articles of incorporation of the several companies do not disclose that they were organized for the sole or primary purpose of supplying water for irrigation of any particular land. In the case of the Humboldt Lovelock Light and Power Company, as indicated by its name, it was incorporated for other purposes in addition to that of storing and transporting water for irrigation. Stock therein might necessarily have a value for reasons wholly distinct from the matter of supplying water for irrigation of lands which, by its charter, is not confined to any definite tracts." (R. 42)

The District Court overlooked the fact that the by-laws of the Humboldt-Lovelock Irrigation Light & Power Company provided as follows:

> "Sec. 1. The proper irrigation of lands belonging to the stockholders of this Company shall always be this Company's primary object, and during the irrigating seasons no waters of this Company shall ever be used for any other purpose if such waters are necessary to properly irrigate the lands of the Company's stockholders." (R. 132)

Irrespective of this fact, however, it is well settled that the provisions of the Articles and By-Laws of the respective companies are immaterial in determining whether or not the shares are appurtenant to the lands. None of the companies has any tangible assets except works for the diversion, transportation and storage of water. These assets are subject to the right of its shareholders to the beneficial use thereof in proportion to their stockholdings, upon payment only of the cost of maintenance. The court has found and held that this right to the beneficial use of the assets of the respective companies, insofar as the same is represented by the shares involved in this litigation, is vested in the plaintiff, and not in the defendant. The Humboldt Lovelock Irrigation Light & Power Company, unlike the other companies, owns, in addition to works for the diversion and storage of water, certain water rights. But these rights the court found to be held by the company for the beneficial use of its shareholders, and that the plaintiff and not the defendant is entitled to the right evidenced by the stock in question to the beneficial use of the water. None of the companies have been operated for profit. Each of them has been operated as a common agency or instrumentality of the owners of the land served by their facilities. In these circumstances, the only right

which the stock can evidence other than the beneficial rights vested in the plaintiff, is a bare proportionate interest in the naked corporate franchise of the respective companies. This right can become valuable, if at all, only in the event that the companies engage in a business activity other than that of diverting, transporting and storing water. Since all of the companies have been in existence for more than a quarter of a century and none of them has engaged in any business or activity other than that of diverting, transporting and storing water, we submit that the right in the naked corporate franchise is so inconsequential and utterly speculative as to make it appropriate for the court to apply the doctrine of *de minimis non curat lex.*

Quite apart from this fact, however, the evidence establishes that so far as the actual operation of the several companies involved in this litigation is concerned, there is nothing to distinguish them from the water companies involved in the cases of *In re Johnson's Estate* (Utah) 228 Pac. 748; *Ireton v. Idaho Irrigation Co.* (Idaho) 164 Pac. 687; *Yellowstone Valley Co. v. Associated Mortgage Investors* (Montana) 290 Pac. 255; *In re Thomas' Estate* (Cal.) 81 Pac. 539, and other decisions, in which the courts have held the stock to be appurtenant to the land so as to entitle a transferee or mortgagee of the land to the stock certificates. Whether or not the Articles of Incorporation of the several companies involved in this action restrict them to diverting, transporting and storing water for the benefit of their stockholders, it must be borne in mind that the Articles of Incorporation are in no sense con-

trolling. The character of a corporation is to be determined by what it does and not by what it may do under its Articles of Incorporation. *Southern California Edison Co. v. R. R. Commission,* 194 Cal. 757, 763, 230 Pac. 661; *Del Mar Water Co. v. Eshleman,* 167 Cal. 666, 140 Pac. 591, 948.

In the case of *In re Thomas' Estate,* 147 Cal. 236, 81 Pac. 539, neither the Articles nor the By-Laws restricted the powers of the corporation there involved to diverting, transporting or storing water for the benefit of its stockholders. As a matter of fact, however, it had confined its activities to doing that and nothing more. The court said this had been done, not in pursuance of any by-laws formally inscribed in the records of the corporation, but solely in accordance with a common understanding of the stockholders. The court held that the stock was nevertheless appurtenant to the land so as to entitle a transferee of the land to the stock certificates.

It is, therefore, clear that notwithstanding the breadth or scope of the powers conferred upon the respective ditch and reservoir companies by their Articles and By-laws, the stock was and is appurtenant to the land so as to pass by conveyance thereof, with the result that defendant cannot, as against plaintiff, assert any interest in or lien upon the stock.

II. THE DEFENDANT NOT BEING AN INNOCENT PURCHASER OR ENCUMBRANCER FOR VALUE CANNOT ASSERT A LIEN ON THE STOCK ADVERSE TO PLAINTIFF.

(a) Assignments of Error Involved:

"10.

"The Court erred in failing to find that at the time the pledge agreement and loan described in Finding XV were made, John G. Taylor had no right, title or interest in or to said water stocks and that the interest of John G. Taylor, Inc., therein was subject to the mortgage theretofore made by John G. Taylor, Inc. to The Reno National Bank, and that the Bank of Nevada Savings & Trust Company at all said times had notice and knowledge that said water stocks had theretofore been sold by John G. Taylor to John G. Taylor, Inc. and by the latter mortgaged to The Reno National Bank." (R. 72)

"7.

"The Court erred in failing to find that, by virtue of the deed described in Finding X, said water stocks were sold, assigned and transferred by John G. Taylor to John G. Taylor, Inc., a corporation." (R. 71)

"8.

"The Court erred in failing to find that, by virtue of the mortgage referred to in Finding XI and XII, said water stocks were mortgaged by John G. Taylor, Inc. to The Reno National Bank." (R. 71)

"9.

"The Court erred in failing to find that, by virtue of the transactions described in Finding XXII, plain-

tiff is now the owner and entitled to the possession of said water stocks." (R. 72)

(b) Discussion:

Irrespective of whether the water stocks in question passed as an appurtenance to the lands now owned by appellant, the transactions shown by the record were sufficient to constitute a conveyance and mortgage of the stock, and by foreclosure of the mortgage appellant is the owner thereof. The record shows that the banks, of which respondent is receiver, had knowledge of these transactions prior to parting with anything of value, and therefore, not being bona fide purchasers without notice, the lien of respondent is subordinate to the rights of appellant.

John G. Taylor on June 9, 1930, was unquestionably the owner of both the lands and the water stocks. The waters stored and transmitted by the water companies for years previously had been used to irrigate the lands in question. The deed of June 9, 1930, from Taylor to John G. Taylor, Inc. conveyed "all shares of stock of any water corporation appurtenant to said lands *or the waters from which are used or have been used in connection with the irrigation or cultivation thereof*" (R. 79). As between the parties this transfer was valid and vested title in the stock to John G. Taylor, Inc. Although not transferred on the books of the water companies from the name of John G. Taylor, he held the stock thereafter merely as a trustee for the company.

12 *Fletcher, Cyclopedia Corporations* 293.

The record also shows that it was intended by the mortgage from John G. Taylor, Inc. to The Reno National

Bank to mortgage all the property which that company then owned. In this connection Mr. Sheehan testified (R. 146):

> "At the time we attempted to consolidate the Taylor loans in the early part of 1932, there was discussion of security with Mr. Taylor, and he furnished a list of all his property, both that of John G. Taylor, Inc. and of himself personally. I do not recall that the water stocks were specifically mentioned. He agreed to furnish as collateral everything that he had. He complied with our request that he furnish as collateral all the stock in the various corporations. * * *
>
> "There was considerable discussion in the early part of 1932 about the consolidation of the Taylor loans, which were previously unsecured. Several discussions were had, both with Mr. Taylor and with the officials of the Reconstruction Finance Corporation. It was repeatedly stated that all of the property of John G. Taylor, Inc. and John G. Taylor was to be put up as security. Following these conversations the loans were consolidated into a single loan of $700,000, represented by note from John G. Taylor, Inc. to The Reno National Bank, secured by chattel mortgage and real estate mortgage. *At the time the real estate mortgage was being prepared, Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so.* This note and the mortgages were later assigned to the Reconstruction Finance Corporation, which advanced to The Reno National Bank more than One Million Dollars."

Irrespective of the sufficiency of the description in that mortgage, and irrespective of compliance with statutory

requirements as to the form of the mortgage, this mortgage was good as between the parties (*Jones on Chattel Mortgages,* 5th ed., p. 3; 11 *C. J.* 454).

Section 987, Compiled Laws of Nevada, which provides that a mortgage of chattels "is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value" unless certain affidavits (admittedly not here present) be attached, is not here involved, since it appears that the state banks for which defendant is receiver had notice and knowledge prior to the time that they parted with anything of value that the water stocks in question were no longer owned by Taylor but were subject to the mortgage held by the R. F. C. made by John G. Taylor, Inc.

Section 987, *Nevada Compiled Laws,* has not in its present form been construed by the Nevada courts. It is, however, identical in terms with Section 2957 of the California Civil Code. The California statute has been construed as available only to one who at the time he parted with value had no knowledge of a prior mortgage not executed with the requisite formalities.

Works v. Merritt, 105 Cal. 467;
Treat v. Burns, 216 Cal. 216.

Such statutes have also been construed as applicable only to tangible personal property and not applying to corporate stocks or other choses in action.

Westinghouse etc. Co. v. Brooklyn R. T. Co., 288 Fed. 221;
Jones on Chattel Mortgages (5th ed.), Sec. 278.

No evidence was introduced respecting the alleged attachment liens of the three state banks for which respondent was receiver, and the only lien claimed by respondent as to which any evidence is shown of record is that derived through the Bank of Nevada Savings & Trust Company under an alleged pledge agreement from John G. Taylor personally. The record shows that this pledge agreement was made approximately two months after the transaction between John G. Taylor, Inc. and The Reno National Bank and after assignment of that mortgage to the R. F. C. It was not until several weeks after the date of the pledge agreement that the Bank of Nevada Savings & Trust Company made any advances or parted with value. At the time the pledge agreement was taken and at the time the Nevada Bank loaned money on the strength thereof, that bank had knowledge of the prior mortgage.

The Nevada Bank was owned by the same stockholders, occupied the same banking rooms and had the same officers, directors and personnel as The Reno National Bank. The Nevada Bank transaction was handled by the same Mr. Sheehan who had handled the transaction between John G. Taylor, Inc. and The Reno National Bank and the assignment of that mortgage to the R. F. C. Sheehan testified that he knew that The Reno National Bank mortgage was intended to cover everything which John G. Taylor, Inc. possessed; that the lands in question attained their value primarily by virtue of their possibility of irrigation derived through the facilities of the water companies whose stocks are here involved. Sheehan testified that in connection with the subsequent Nevada Bank

transaction he did not see (and therefore could not have relied upon) the pledge agreement signed by Taylor personally, on which defendant's lien is founded. In fact, Sheehan testified that he had not seen the certificates representing these stocks throughout that period until he saw them at the trial. His signature appears as a witness to the endorsement of John G. Taylor on the stock certificates in question (R. 143). In light of his testimony, Sheehan could have witnessed Taylor's signature only in connection with some antecedent transaction, confirming his description of The Reno National Bank transaction, as to which he testified (R. 147):

> "At the time the real estate mortgage was being prepared Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so."

The knowledge acquired by Sheehan, who was the sole representative of the Nevada Bank in the transaction relied on by respondent, cannot be repudiated merely because Sheehan acquired that knowledge while acting for The Reno National Bank. The knowledge possessed by an agent of two or more corporations is attributable to each irrespective of the capacity in which such knowledge was acquired.

> *Restatement of the Law of Agency,* §276;
> *Cook v. American T. & W. Co.* (R. I.) 65 Atl. 641;
> *Louisville Trust Co. v. Louisville R. R. Co.,* 75 Fed. 433.

The deed of June 9, 1930, was sufficient to pass title to the water stocks from Taylor to John G. Taylor, Inc. The

mortgage of March 12, 1932 was intended to and did mortgage that stock to The Reno National Bank and by foreclosure of that mortgage appellant is now the owner of the stock. While it is true that when the stock was permitted to remain in the name of John G. Taylor individually, a bona fide purchaser for value of the stock from Taylor might be protected, and while such a purchaser would be entitled to the benefit of Section 987, *Nevada Compiled Laws,* in view of the fact that the mortgage did not contain the affidavit thereby required, respondent is not such a bona fide purchaser. As receiver he can stand in no better place than the banks for which he is acting. These banks at the time they parted with value had knowledge of the conveyance of the stock from Taylor to the corporation and of the mortgage by the corporation to The Reno National Bank. Having actual knowledge of these transactions, informalities or irregularities in the transfer of the mortgage cannot be relied on and liens asserted based on transactions entered into with such knowledge are subordinate to the interest of the prior purchaser or encumbrancer. Appellant, therefore, having succeeded, through foreclosure of The Reno National Bank mortgage, to the title to the property affected thereby, is now the owner of the stock and entitled to its possession as against respondent.

It is respectfully submitted that the decree should be reversed, with instructions to enter a decree adjudging appellant to be the owner of the stocks described in the

complaint, free from any claim of respondent, and directing the surrender of such stocks to appellant.

Respectfully submitted,

MAURICE E. HARRISON,
T. W. DAHLQUIST,
JAMES S. MOORE, JR.,
Attorneys for Appellant.

BROBECK, PHLEGER & HARRISON,
ORRICK, DAHLQUIST, NEFF & HERRINGTON,
Of Counsel.